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FEB 1996

February 6, 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, DC 20554

Re: CC Docket No. 94-1; Price Cap Performance Review for Local Exchange Carriers

CC Docket No. 93-124; Treatment of Operator Services Under Price Cap Regulation

CC Docket No. 93-197; Revisions to Price Cap Rules for AT&T

Dear Mr. Caton:

Enclosed herewith for filing are the original and four (4) copies of MCI Telecommunications Corporation's Reply Comments in the above-captioned proceedings.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI comments furnished for such purpose and remit same to the bearer.

Sincerely yours,

Chris Frentrup
Senior Regulatory Analyst
Federal Regulatory

Enclosure
CF

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20054

In the Matter of	)	
	)	
Price Cap Performance Review	)	
for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Treatment of Operator Services	)	
Under Price Cap Regulation	)	CC Docket No. 93-124
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

REPLY COMMENTS

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EXECUTIVE SUMMARY

The Commission should not adopt the LECs' proposals for simplifying the introduction of new services. The current Part 69 waiver requirement and the new service pricing rules provide important customer safeguards.

Nor should the Commission adopt the LECs' proposals for revising the basket structure. As MCI stated in its initial comments, the Commission should tie any grant of further pricing flexibility for the LECs to reductions in access rates toward economic cost and the presence of competitive checks on LEC pricing. Granting additional pricing flexibility while allowing rates to remain excessively high will allow the LECs to discriminate unreasonably among their customers and maintain their excessive earnings. Premature grant of LEC pricing flexibility will have a detrimental effect on two markets, the market for interexchange services and the interstate access market. Moreover, it is likely that grant of pricing flexibility in the interstate access market will have detrimental effects for competition for intrastate access and local services, as well.

Finally, the LECs' proposal for the criteria under which they should be granted streamlined treatment should not be adopted. The fact that a market is addressable as defined by the LECs will not ensure that the LEC faces competition that is sufficiently strong to constrain its pricing behavior.

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REPLY COMMENTS

I. INTRODUCTION

MCI hereby submits its reply comments in the above-captioned dockets.[1] The local exchange carriers (LECs) have made several proposals for changes to the price cap plan regarding the treatment of new services, including market trials and alternative pricing plans (APPs). In addition, the LECs propose criteria for determining when the LECs should receive even greater regulatory flexibility. The LECs' proposals would allow the LECs greater pricing flexibility which they could use to harm competition in the interexchange market.

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[1] In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1; Treatment of Operator Services Under Price Cap Regulation CC Docket No. 93-124; and Revisions to Price Cap Rules for AT&T, CC Docket No. 93-197, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1; Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, FCC 95-393, released September 20, 1995 (Second Further Notice).

Additional pricing flexibility should be granted to the LECs only if their access rates are first reduced to economic cost. If LEC rates are allowed to remain at their current levels and the LECs are granted additional pricing flexibility, the LECs will be able unreasonably to discriminate among their customers, funding rate cuts for some customers with rate increases for others while preserving their current inflated revenue stream. Premature grant of LEC pricing flexibility will therefore have a detrimental effect on two markets, the market for interexchange services and the interstate access market. Moreover, it is likely that grant of pricing flexibility in the interstate access market will have detrimental effects for competition for intrastate access and local services, as well.

II. THE COMMISSION SHOULD NOT SIMPLIFY THE NEW SERVICE REQUIREMENTS AS THE LECS PROPOSE

Several LECs support the Commission's proposal to simplify the Part 69 waiver process. They argue that they should be able to introduce new switched services without being required first to obtain a Part 69 waiver. The waiver process is used, the LECs claim, by their competitors to delay the introduction of services which allow the LECs to compete.[2] The LECs also state that new services should be presumed to be in the public interest, and that those opposing the waivers have the burden under the Communications Act of demonstrating that the new service is not in the public interest.

<u>See</u>, <u>e.g.</u>, Southwestern Bell Comments at 16.

The LECs are wrong on both counts. Oppositions to the LECs' Part 69 waiver requests are primarily filed by the LECs' customers, not its competitors. The LECs' customers have every incentive to have new services introduced. As MCI noted in its initial comments, any delays that are experienced can be attributed to a persistent pattern of unclear and incomplete explanations by the LECs of proposed access structures. Rather than deleting the requirement for obtaining a Part 69 waiver, the Commission should develop unambiguous, detailed guidelines for Part 69 waiver requests: (1) a list of Part 69 rate elements and corresponding rate elements the LEC would like to charge, together with a brief explanation of the costs that each element will recover and how that element will be priced (per minute, per query, etc.); (2) sample tariff pages; (3) a detailed explanation of why the request is being made with reference to the Commission's waiver standard; and (4) an explanation of the competitive effects the new structure will likely have in the interexchange market and access market. This information should be collected in a standard format, similar to the tariff review plan

In addition the LECs cite Section 7 of the Communications Act[3] to support their claim that parties opposing Part 69 waiver requests have the burden of showing that the new service is not in the public interest. This section of the Act is not discussing the tariff review process; it deals with new

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47 U.S.C. Section 157.

services, such as alternative uses of the spectrum. The Commission adopted the Part 69 tariff structure because it determined that, inter alia, a standardized access structure would best promote competition in the interexchange market. If the LEC wishes to deviate from that structure, it has the burden of proof that the proposed structure better meets the public interest than the existing Part 69 structure. Even if this section does apply to Part 69 waivers, part (b) of that Section states that the Commission has 12 months to determine whether a new service is in the public interest.

The LECs also argue that the new service tariff filings should be made on 14-days' rather than the current 45-days' notice, because the longer notice period disadvantages them in the competitive marketplace. They also argue that these new service filings should be made with either no cost support[4] or filed under confidential cover, subject only to public release under the Freedom of Information Act (FOIA).[5]

A longer notice period can disadvantage the LECs in the competitive marketplace only if there is a competitive marketplace. The LECs require waivers only for their switched services, for which there is very limited competition. As the attached study by Hatfield Associates, Inc. shows, there is very limited competition for the local exchange companies, now and in the

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4 See USTA Comments at 21.

5 See Ameritech Comments at 14.

foreseeable future[8] The LECs' high and growing earnings, consistent access demand growth, and practice of pricing at or near their caps are not what would be expected if the LECs faced significant competition. Similarly, it is unlikely that either cable companies, cellular companies, or the coming Personal Communications Service (PCS) providers will be able or willing to provide effective competition with the LECs. It is hard to see how the waiver requirement can be seriously affecting the LECs in a market where they face such limited competition.

The Commission should not allow new services to be filed on only 14-days' notice. Additional time is necessary to examine LEC cost support to ensure that rates are neither too high nor too low. Parties must assess the reasonableness of the LECs' forecasts of demand and of their cost support. This takes longer than the mere five days that the Commission's rules allow for comments on 14 day tariff filings.

MCI has filed oppositions to 61 new tariff filings by the price cap LECs since September of 1994. Of those, all but eight have had their effective date delayed, 33 of them for more than 30 days. The LECs have demonstrated an inability to meet the minimal requirements under the current new services' rules. Given the LEC's track record, the Commission should not allow the LECs to file new service filings on even shorter notice.

<u>See</u> Attachment A, The Enduring Local Bottleneck II; A Preliminary Assessment, by Hatfield Associates, Inc.

The 5 days which parties have to comment on LEC 14-day tariff filings also argues against adopting Ameritech's proposal that new services be filed on 14-days' notice under confidential cover, with parties getting access to the confidential data only under FOIA. To effectively participate in a tariff filing under Ameritech's proposal, parties would have to obtain the filing, petition the Commission for access to the data under FOIA, get an order out of the Commission requiring release of the data, obtain the data under that order, analyze the data, and prepare their comments, all within five days. This is of course impossible and should not be considered a serious proposal.

BellSouth proposes to remove market trials from price caps.[7] Under this proposal, market trials would be allowed without any cost support or requirement of a Part 69 waiver. According to BellSouth, the limited duration and scope associated with market trials warrants only minimal oversight. If the Commission adopts BellSouth's proposal, the LECs will be able to violate several Commission policies, including providing special pricing for individual customers, geographically deaveraging rates, or bundling enhanced or non-regulated services with their regulated services. MCI does not see how the Commission can reasonably differentiate between a market trial whose true purpose is to determine the technological and market feasibility of a service and a trial whose purpose is to provide a customer- or geographic area-specific

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[7] See BellSouth Comments at 14.

arrangement. The Commission cannot rely on the LEC's characterization of the purpose of the trial. Each market trial must be examined to determine that the service covers its costs, and that the service is not being offered simply to the benefit of one customer, or to geographically deaverage rates. The Commission's policies have been developed over the past twelve years to ensure that competition is maximized for most services. The Commission must continue to examine all LEC new services, including market trials, to ensure that they do not violate Commission policies. This examination can best be performed in a Part 69 waiver proceeding.

The LECs also favor the Commission's proposal to allow them to offer Alternative Pricing Plans, including promotions. MCI believes that APPs should be treated like any other new service. The LEC must obtain a Part 69 waiver and make a cost-based showing when the service is introduced. The rates for the service must be incorporated into the price indexes in the annual filing in the year following the year in which the service is introduced.

As stated in our initial comments, the primary concern MCI has with APPs is the potential for their use by the LEC to unreasonably discriminate among its customers. If the APPs the LEC offers are indeed generally available, the potential for competitive harm is somewhat minimized.[8]

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8 However, a plan that is facially available to all may in reality be available only to a single IXC with particular characteristics -- e.g., call volume minimums can restrict availability.

However, promotional pricing that is limited in its duration raises much greater issues of discrimination. Unlike other pricing plans that do not carry end dates, promotional pricing can be used to discriminate among interexchange customers and to harm emerging access competition. This effect can be further exacerbated by the use of eligibility windows. The result can be a steeply discounted plan that is effectively targeted to one customer. Even worse, because the LEC would receive price cap credit for the discount, the LEC has the ability to raise other rates in order to maintain its revenue stream. This capability could seriously harm competition in the interexchange industry. MCI strongly urges the Commission not to permit promotional pricing, defined as pricing plans that have either a window of eligibility or an end date. If such pricing is permitted, it should under no circumstances be given price cap credit.

The LECs also argue they should be allowed to provide customer-specific rates in response to requests for proposal (RFPs).[9] The use of customer-specific pricing is an extraordinary degree of pricing flexibility which the LECs should not be granted. As the Commission itself recognized in its Transport Expanded Interconnection Order, and recently re-affirmed in an Order terminating an investigation of Southwestern Bell Transmittals 2433 and 2449, the LECs continue to possess substantial market power in the provision of special access and switched transport service, and granting the LECs additional

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[9] See USTA Comments at 26.

flexibility at this stage could stifle entry and harm customers of less competitive services.[10] The LECs have not demonstrated, nor can they, that competition has developed sufficiently to justify a change in this Commission conclusion. The LECs should not be granted the right to provide customer-specific tariffs in response to RFPs.

The LECs have not even used the pricing flexibility the Commission has already granted them.[11] In addition, the mere existence of an RFP does not mean that there are multiple companies capable of meeting the requirements. Nor does it mean that the LECs are disabled from responding to the RFP using tariffs of general availability. The LECs already have sufficient flexibility under the price cap rules to allow them to effectively compete.

III. THE LECS MAKE NO SHOWING THAT THE ADDITIONAL PRICING FLEXIBILITY ALLOWED BY THEIR PROPOSALS FOR CHANGES TO THE BASKET STRUCTURE WOULD REFLECT COST DIFFERENCES

The LECs make several proposals regarding re-alignment of the baskets. USTA proposes that the Commission create five baskets: (1) Common Line,

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[10] See Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Transport Phase II, 9 FCC Rcd 2718, 273[illegible] (1994) (Transport Expanded Interconnection Order); Southwestern Bell Telephone Company Tariff FCC No. 73, CC Docket No. 95-140, FCC 95-476, released November 29, 1995. See also Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Memorandum Opinion and Order, 9 FCC Rcd 5154 (1994).

[11] For instance, Southwestern Bell has implemented zone density tariffs for its switched transport, but does not price the zones at different rates.

which would include subscriber line charges (SLCs) and carrier common line (CCL) charges; (2) Switching, which would include categories for Local Switching (LS), Information (including Billing Name Address, Directory Assistance (DA), and DA Call Completion), and Database (including 800 Database, 800 Vertical Services, and Line Information Database); (3) Transport, which has categories for Analog (Voice Grade, Audio, Video, and Wideband), Digital (Digital Data Service, DS1, and DS3), Tandem (Tandem Switching and Tandem Transport), and the Interconnection Charge; Interexchange; and (5) Video Dial Tone. USTA proposes to set up zone sub-indexes for CCL, LS, and all the categories in the Transport basket. It would eliminate the separate sub-indexes for DS1 and DS 3 services, and the Service Band Indexes for the separate Analog and Tandem services. USTA also proposes that companies be allowed to adopt an optional basket structure that would group SLC, CCL and Local Switching rates into separate categories in a basket for Small Access customers and a separate basket for Large Access customers. Information and Database services would be moved into separate categories in the Transport basket under this proposal.[12]

The Commission should not adopt this proposal. This proposal would allow the LECs greater flexibility than they now have to adjust some rates downward, and recover that revenue by raising other rates. As MCI noted in

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[12] See USTA Comments at 34-35 and Attachment 6.

its initial Comments, the LECs' rates are currently well above economic cost. Until rates are driven down to economic cost, the LECs must not be given greater flexibility to adjust their rates.[13] The LECs can damage competition in the interexchange marketplace if they are allowed to realign the recovery of non-economic costs to the disadvantage of one set of access customers.[14]

The LECs have not explained how their costs differ for CCL, LS, and IC by zone. The Commission adopted zone pricing for transport because it believed that traffic density was a good proxy for cost differences.[15] The LECs have not demonstrated that the costs for CCL, LS, or IC vary by zone. In fact, the LECs have never demonstrated what costs are included in the IC at all, so it is impossible to determine how those costs vary. The Commission should not allow zone pricing for these rates until it determines that the costs in fact do vary over the zones.

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[13] See MCI Comments at 4-8.

[14] It is for this reason that the Commission should not adopt Sprint's proposal that the LECs be allowed to target the inflation minus productivity adjustment to the Price Cap Index to the IC. Sprint Comments at 10. This will allow all other rates to be higher, and the "costs" currently reflected in the IC will eventually be recovered in whatever rate the LECs decide to raise. This will provide the LECs too much flexibility.

[15] See Expanded Interconnection with Local Telephone Company Facilities; Amendment of the Part 69 Allocation of General Support Facility Costs, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992) at para 179.

IV. ADDRESSABILITY SHOULD NOT BE THE SOLE CRITERION BY WHICH THE COMMISSION JUDGES WHETHER THE LECS WARRANT RELAXED REGULATORY TREATMENT

The LECs argue that streamlined regulation should be allowed when the relevant market is addressable.[16] The relevant market is determined by geographic area, service, and customer class. The geographic area that the LECs propose is the contiguous wire centers served by the LECs in the area in which multiple suppliers compete for the same customers within an exchange or metropolitan area.[17] The relevant services proposed by the LECs are the categories they propose for the re-alignment of the baskets discussed in Section IV, supra Finally, customers are divided into small and large access customers. Thus under the LEC proposal, the LEC can qualify for streamlined treatment for, e.g., business customers of DS1, DS3, and/or DDS service within one city. As long as there was one provider other than the incumbent LEC available to serve those customers, the LEC would qualify for streamlined treatment.

USTA proposes that the Commission examine supply responsiveness and demand responsiveness to determine whether an area is competitive. When alternative access providers can serve 25 percent of the LECs demand, that would show that the relevant market is addressable, and thus that streamlined

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[16] See USTA Comments at 38 et seq. An area is addressable when multiple suppliers compete for the same customers within that area.

[17] See USTA Comments at 41.

treatment for the LEC was warranted. To determine whether an are is addressable, USTA proposes that the Commission require all interstate access providers to file with the Commission a description of the area in which they make each of their services generally available, either by a list of zip codes or other geographic areas served, or by a service area map. Alternatively, the access provider should file detailed maps showing its network facilities in each area served, including planned additions.

This proposal by the LECs is anti-competitive. It would give the LECs extensive information about the areas their competitors serve, allowing them to target those areas more carefully. The Commission should not adopt this reporting requirement.

In addition to urging the Commission to examine supply responsiveness, the LECs also propose that the Commission consider demand responsiveness in determining whether a market segment should be streamlined. If any customers had used the service of the alternative providers, the LECs claim, that would indicate that those alternative providers were viewed as a competitive alternative by the market. However, the LECs also state that they should not have to achieve some pre-determined market share level before they get streamlined treatment, because market share is not a good proxy for market power

The mere existence of alternative providers does not guarantee that the market is strong enough to restrain LEC prices. One customer taking service from an alternative provider may merely reflect the unique needs of that customer. The Commission must consider LEC market share as a relevant factor. While there is no magic level of market share which will automatically justify streamlined treatment, it is clearly not true that the mere existence of a competitor can justify such treatment.

V. BELOW-CAP PRICING DOES PROVIDE INFORMATION THAT COMPETITION EXISTS

Several LECs argue that below-cap pricing is not necessary as proof that competition exists. Companies will have different abilities to price below cap, these LECs argue, based on the productivity factor and other adjustments the Commission requires. In addition, the Commission's price cap rules which restrict price increases after price decreases themselves discourage pricing below cap. In addition, "sustained pricing below the cap could also reduce the subsidies necessary to offset shortfalls generated by services priced below cost."[18]

The LECs do not need flexibility which allows them to subsidize some rates that are below cost by charging other rates that are above cost. MCI would expect that as truly effective competition develops, the LECs should have to cut their rates even more than they did, and thus they should have consistently below cap rates. The Commission should not dismiss the indication of the lack of competition that pricing at the cap provides.

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18 See USTA Comments at 54.

NYNEX claims that the initial targeting of rates affects a companies ability to price below cap, noting that New England Telephone's rates used to initialize price caps were not targeted to the allowed rate of return, which was a major factor in NYNEX's lower formula adjustment for 1991. Neither of these statements are true. As for all the LECs, NYNEX's initial price cap rates were set in the 1990 annual access filing, as adjusted for the change in the rate of return to 11.25 percent. NYNEX was earning 11.25 percent on its interstate access services through the third quarter of 1991. It was only the large charge that NYNEX took for a corporate downsizing effort in the fourth quarter of 1991 that led to its having a lower formula adjustment for 1991.

VI. CONCLUSION

The Commission should not adopt the LECs' proposals for simplifying the introduction of new services. The current Part 69 waiver requirement and the new service pricing rules provide important customer safeguards.

Nor should the Commission adopt the LECs' proposals for revising the basket structure. As MCI stated in its initial comments, the Commission should tie any grant of further pricing flexibility for the LECs to reductions in access rates toward economic cost and the presence of competitive checks on LEC pricing. Granting additional pricing flexibility while allowing rates to remain excessively high will allow the LECs to discriminate unreasonably among their customers and maintain their excessive earnings.

Finally, the LECs' proposal for the criteria under which they should be granted streamlined treatment should not be adopted. The fact that a market is addressable as defined by the LECs will not ensure that the LEC faces competition that is sufficiently strong to constrain its pricing behavior.

Respectfully submitted,
MCI TELECOMMUNICATIONS CORPORATION

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February 6, 1996

STATEMENT OF VERIFICATION

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on February 6, 1996

Chris Frentrup
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Attachment A

THE ENDURING LOCAL BOTTLENECK II: A PRELIMINARY ASSESSMENT

PREPARED ON BEHALF OF

MCI TELECOMMUNICATIONS CORPORATION

BY

HATFIELD ASSOCIATES, INC.

JANUARY 9, 1996

EXECUTIVE SUMMARY

There is a widely held belief, based primarily on reporting in the popular and business press, that competition in exchange telephone services provided by the local telephone companies is a flourishing reality, or soon will become so. In February of 1994, Economics and Technology, Inc. and Hatfield Associates, Inc. released The Enduring Local Bottleneck ("ELB"). ELB provided a comprehensive technical, economic and policy examination of the state of local exchange competition at that time, as well as an assessment of the potential for increased competition in the next five to ten years.

ELB found that the road to significant, ubiquitous local exchange competition will be long and difficult. This finding in turn leads to the key policy implication of ELB: It would be premature to 1) establish regulatory principles and practices based on the premise that widespread local exchange competition is occurring or is imminent; or 2) eliminate or lessen the competitive safeguards imposed on the incumbent local telephone companies that are specifically intended to create an environment in which competition can develop as a substitute for regulation. Stated alternatively, the principal policy conclusion of ELB was that the proper sequencing of pro-competitive and deregulatory polices was essential to the development of viable local competition.

In light of rapidly changing technology, MCI Telecommunications Corporation, one of the original sponsors of ELB, has retained Hatfield Associates, Inc. ("HAI") to update the engineering-economic analysis in ELB. The modeling effort is currently underway. In the meantime, this preliminary report addresses various qualitative aspects of the ongoing technology and business assessment.

The conclusion reached is that the overall findings in the earlier report appear to be equally valid today. Local telephone company predictions about the imminent arrival of effective local competition are as inaccurate today as they were two years ago. The degree of local competition is still trivial, as demonstrated by an analysis of structure, conduct and performance in the market.

There have been no cost breakthroughs in the technologies available to competitors that would suggest the investment results found in ELB will substantially change. Nor have any hypothetical "volume production" cost reductions materialized, because these technologies are not yet in mass production.

The ELB business case analysis is being revised to determine whether any factors have changed to warrant a greater degree of optimism. The qualitative changes identified thus far suggest the answer is no. A primary basis for this conclusion is that it has become clear since ELB that the local telephone companies' cost of providing basic local exchange service is substantially lower than price in many geographic areas in which competitive providers may wish to provide service. As a result, the local telephone companies may be able to substantially reduce their prices. That being the case, the assumption in ELB that competitors can price their service only a small amount below current local telephone company prices is likely to be wrong. It follows that the business case for local entry is not as optimistic as originally thought.